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In The

Supreme Court of the United States

October Term, 1994

HOME SAVINGS OF AMERICA, FSB,

Petitioner,

vs.

MARCELLA T. MAYNARD,

Respondent.

Petition For A Writ Of Certiorari To The Court Of Appeal Of The State Of California, Second Appellate District

PETITION FOR WRIT OF CERTIORARI

PAUL W. CANE, JR.
Counsel of Record
KATHLEEN L. MCACHRAN
PAUL, HASTINGS, JANOFSKY & WALKER
Twenty-third Floor
555 South Flower Street
Los Angeles, California 90071
(213) 683-6000

FRANKLIN R. WURTZEL
Legal Department
Home Savings of America, FSB
4900 Rivergrade Road
Irwindale, California 91706
(818) 814-7675

Attorneys for Petitioner
Home Savings of America, FSB

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

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QUESTION PRESENTED

Whether federal law – the Home Owners' Loan Act and its implementing regulations – preempts a federal thrift employee's state-law wrongful-discharge claim, where the claim is based on an alleged implied employment contract forbidden by federal law.

PARTIES TO THE PROCEEDINGS AND RULE 29.1 STATEMENT

The only parties to this action are plaintiff/respondent Marcella T. Maynard and defendant/petitioner Home Savings of America, FSB, a federal savings bank. Home Savings of America is a wholly-owned subsidiary of H.F. Ahmanson & Co. There are no subsidiaries of Home Savings and H.F. Ahmanson (other than wholly-owned subsidiaries).

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PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEAL OF THE STATE OF CALIFORNIA, SECOND APPELLATE DISTRICT

Petitioner Home Savings of America, FSB, respectfully petitions this Court for a writ of *certiorari* to review the decision of the Court of Appeal of the State of California, Second Appellate District.

OPINIONS BELOW

The unpublished opinion of the California Court of Appeal was filed on February 17, 1994, and is reproduced in the Appendix beginning at page App. 1. The California Supreme Court denied the discretionary petition for review in an unpublished order dated May 12, 1994. That order is reproduced in the Appendix at page App. 6.

JURISDICTION

The judgment of the court of appeal was entered on February 17, 1994. The timely petition for review to the California Supreme Court was denied on May 12, 1994. The instant petition for *certiorari* is filed within 90 days of

that date. Sup. Ct. R. 13.1.[1] The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).[2]

STATUTORY PROVISIONS INVOLVED

The applicable statutes and regulations are set forth beginning at page App. 7 of the Appendix.

STATEMENT

This is a straightforward case of preemption. California and some other states recognize "implied" employment contracts arising from, *inter alia*, the employee's

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[1] This Court's review of the decision of the California Court of Appeal is permissible under 28 U.S.C. § 1257 because the California Supreme Court denied discretionary review. *E.g.*, *Interstate Circuit, Inc. v. Dallas*, 390 U.S. 676, 678 n.1 (1968) (where the state court of last resort denies discretionary review, the petition to the Supreme Court is permissible from the judgment of the intermediate state court).

[2] There is a final judgment for purposes of § 1257(a) even though the California Court of Appeal's decision remanded the case for trial on the state-law question presented. A final judgment exists "where the federal issue has been finally decided in the state courts [even though there are] further proceedings pending in which the party seeking review [in the Supreme Court] might prevail on the merits on nonfederal grounds, thus rendering unnecessary review of the federal issue by [the Supreme Court], . . . where reversal of the state court on the federal issue would be preclusive of any further litigation on the relevant cause of action." *Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469, 482-83 (1975), *quoted in* Robert L. Stern, Eugene Gressman & Stephen M. Shapiro, *Supreme Court Practice* 131 (6th ed. 1986).

length of service and satisfactory job performance. No formal employment contract – indeed no written document at all – is required.

Federal law, however, regulates the operations of federally chartered thrift institutions. As this Court has held, federal law controls " 'the powers and operations of every Federal savings and loan association from its cradle to its corporate grave.' " *Fidelity Federal Savings & Loan Association v. de la Cuesta*, 458 U.S. 141, 160 (1982) (citation omitted). Federal law prohibits, for federal thrift employees, exactly the implied contracts that California law would recognize. Indeed, federal law prohibits *all* employment contracts for federal thrift employees, except those that are (i) in writing, and (ii) approved by the thrift's board of directors. The state law of "implied" employment contracts thus conflicts with federal law.

In these circumstances, state law must yield. Yet the California state court in the instant case recognized an implied employment contract in derogation of federal law. Because the California court's decision undermines an important U.S. government regulatory interest, and because the California court's holding conflicts with that of the courts of other states, this Court should grant *certiorari*.

The relevant facts are few, and undisputed. Petitioner Home Savings is a federal savings bank covered by the Home Owners' Loan Act (HOLA), 12 U.S.C. § 1462 *et seq.*, and subject to federal regulations promulgated by the Office of Thrift Supervision (OTS). (App. 2.) Respondent Marcella T. Maynard, a bank officer, was terminated from her employment in October 1991. (App. 2.) The termination occurred

after the branch for which Maynard was responsible sustained a $280,000 loss attributable to its failure to adhere to proper cash-handling procedures. Home Savings' board of directors ratified her termination by resolution adopted at its next meeting, held on October 22, 1991. At no time during Maynard's employment with Home Savings did she have a written, board-approved employment contract. (App. 2.)

Maynard sued on May 15, 1992, alleging that her termination violated an "implied contract" that, she said, guaranteed her employment for the balance of her working life. The "contract," Maynard alleged, derived from her years of service and purportedly competent job performance. She alleged only contract claims;[3] she did *not* allege discrimination, or that Home Savings terminated her for any other improper motive.[4]

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[3] Her complaint alleged, in addition to the implied contract claim, a claim for breach of an "implied covenant of good faith and fair dealing." That claim is, under California law, a subspecies of contract claim. *E.g., Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 689-90, 254 Cal. Rptr. 211 (1988) (the covenant of good faith and fair dealing in the employment context is an "*ex contractu* obligation, namely one arising out of the contract itself").

[4] Because only contract-based claims are alleged, this Court need not decide to what extent, if at all, the OTS regulations preempt state-law claims other than those for breach of contract. Home Savings assumes for purposes of this case that different rules may well apply to persons who are terminated for a reason offensive to public policy, such as discrimination, for refusing to commit a crime, or for reporting wrongdoing to appropriate public officials. The instant case, by contrast, involves no such claim – only a claim that, by reason of her length of service and job performance, Maynard somehow had acquired an ephemeral implied-contract right.

The trial court granted Home Savings' motion for summary judgment, finding that Maynard's claims were preempted by federal law. (App. 2.) Maynard timely appealed.

The California Court of Appeal reversed. It acknowledged that Home Savings is a federal savings institution chartered under § 5 of the HOLA and subject to OTS regulations (App. 2); that Maynard never had a board-approved employment contract (*id.*); and that, indeed, Maynard did not have *any* kind of written employment contract (*id.*). The court of appeal nevertheless reversed the trial court's award of summary judgment to Home Savings. The court of appeal based its decision, without further analysis, on earlier California cases which had held that federal law does not preempt state implied-contract law.

The California Supreme Court denied review on May 12, 1994.[5] This timely petition followed. *See supra* notes 1-2.

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[5] There is no conflict in the *California* cases; thus, it was unremarkable that the California Supreme Court declined to grant discretionary review. *See* Cal. Ct. R. 29.2 (citing an *intra*-state conflict as a chief reason for granting review). As noted below, there is a conflict, but the conflict is between the California decisions and those from other states.

REASONS FOR GRANTING THE PETITION

The Court should grant review for two primary reasons. First, the decision undermines an important regulatory interest of the United States government. Second, the instant case and other California cases conflict with those of other state and federal courts. This Court should grant review to resolve the conflict.

I. THE RULE ANNOUNCED IN CALIFORNIA IMPEDES THE U.S. GOVERNMENT'S EXERCISE OF ITS REGULATORY RESPONSIBILITIES OVER THE THRIFT INDUSTRY

Under the Supremacy Clause of the United States Constitution, federal law of course preempts all conflicting state laws. U.S. Const. art. VI; *see, e.g., Hillsborough County v. Automated Medical Labs, Inc.*, 471 U.S. 707, 712 (1985). Preemption arises where Congress' express language indicates an intent to supersede state law, or where the scheme of federal regulation "is so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it." *de la Cuesta*, 458 U.S. at 153 (citation omitted). Even where Congress' intent to preclude state regulation is neither expressly stated nor inferred from a pervasive scheme of federal regulations, state law is preempted to the extent it actually conflicts with federal law. *Id.* State law is deemed to be conflicting with federal law (i) when compliance with both state and federal law is impossible, or (ii) when state law " 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.' " *Hillsborough*, 471 U.S. at 712 (citation omitted).

In the instant case, preemption obtains. Congress has exercised its power completely to control the thrift industry. And the state implied-contract law in question conflicts directly with federal law.

A. The Federal Regulations Governing Savings And Loan Associations Expressly Provide For Preemption Of State Law.

More than 60 years ago, during the Great Depression, Congress recognized that the financial health of savings and loan associations was a critical federal interest. To ensure that these institutions remained financially viable, Congress enacted the HOLA as a " 'radical and comprehensive response to the inadequacies of existing state systems.' " *de la Cuesta*, 458 U.S. at 160 (citation omitted). The HOLA provided for the creation of a system of federal savings institutions regulated by a single federal agency, known today as the OTS. 12 U.S.C. §§ 1462a-1464; *see de la Cuesta*, 458 U.S. at 159-60.[6]

OTS regulations preempt state law. In Section 5(a) of the HOLA, Congress expressly granted the OTS plenary authority to regulate all aspects of the thrift industry:

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[6] The original federal agency created by the HOLA was the Federal Home Loan Bank Board (FHLBB). In 1989, Congress passed the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), which amended the HOLA by replacing the FHLBB with the OTS. *See, e.g., First Gibraltar Bank v. Morales*, 19 F.3d 1032, 1041 (5th Cir. 1994). This petition will refer to the OTS and its predecessor collectively as "OTS."

> [The OTS] is authorized, under such regulations as [it] may prescribe, "to provide for the . . . operation and regulation of . . . Federal savings associations. . . . "

12 U.S.C. § 1464(a).

The OTS exercised the authority delegated to it under the HOLA. It promulgated 12 C.F.R. § 545.2. The plain language of this section completely and exclusively controls all aspects of the operation of institutions within the thrift industry:

> The[se] regulations . . . are promulgated pursuant to the plenary and exclusive authority of the [OTS] to *regulate all aspects of the operations of Federal savings associations*, as set forth in section 5(a) of the [Home Owners' Loan] Act [of 1933, 12 U.S.C. 1464]. This exercise of [OTS] authority is *preemptive of any state law purporting to address the subject* of the operations of a Federal savings association. [Emphasis added.]

The preemptive force of the regulations has been widely acknowledged. As this Court explained in *de la Cuesta*, federal regulations promulgated under the HOLA have the same preemptive force as federal statutes and thus preempt all conflicting state laws. 458 U.S. at 162-63.[7] The HOLA, the Court noted, reflected Congress' recognition of "the inadequacies of existing state systems"; Congress decreed that federal law would control

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[7] It is well established, of course, that federal regulations can preempt state law, where a federal agency acts within the scope of authority delegated by Congress. *E.g., City of New York v. FCC*, 486 U.S. 57, 63-64 (1988); *Louisiana Public Serv. Comm'n v. FCC*, 476 U.S. 355, 369 (1986).

"the powers and operations of every Federal savings and loan association from its cradle to its corporate grave." *de la Cuesta*, 458 U.S. at 160, 145 (citation omitted); *accord, e.g., Glendale Federal Savings & Loan Association v. Fox*, 459 F. Supp. 903, 910 (C.D. Cal. 1978) (when a regulation is promulgated governing an aspect of the operation of federal savings associations, "that regulation governs exclusively and preempts any attempt by a state to regulate in that area"), *cert. denied*, 458 U.S. 1121 (1982).

Just this year, for example, the Court of Appeals for the Fifth Circuit conducted a detailed review of the preemptive effect of the OTS regulations. *First Gibraltar Bank, FSB v. Morales*, 19 F.3d 1032 (5th Cir. 1994), *petition for cert. filed*, No. 94-209 (July 28, 1994).[8] At issue in that case was the Texas Homestead law, set forth in the Texas Constitution. Although *Morales* is not an employment contract case, its analysis is instructive. The Texas Homestead law in some circumstances precluded foreclosure on, or other creditor resort to, an individual's personal residence. Lenders (supported by the OTS as *amicus curiae*) contended that the Homestead law was preempted by the HOLA to the extent that the Homestead law prohibited foreclosures to enforce liens taken in certain mortgage transactions. Reason: OTS regulations allowed foreclosure as as a remedy in these circumstances. The Fifth Circuit applied what it called a "heightened scrutiny" of

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[8] While the issues in *Morales* and the instant case are distinct, they are sufficiently related that the Court should consider granting *certiorari* in both cases and arguing them in tandem.

the lenders' preemption claim, because the dispute involved real property, and "[r]eal property law has been recognized by the Supreme Court as a matter of special concern to the states." *Id.* at 1039. Yet the court still held that the OTS had the authority to preempt state law even in this sensitive area, and had done so through its regulations. *Id.* at 1049-50 (federal control is necessary so that the federal government can exercise its responsibility to assure "financially sound institutions able to supply financing for home construction and purchase") (citation omitted).

Texas contended, however, that federal preemption applied, if at all, only to measures more palpably related to maintaining the financial soundness of the thrifts. The Fifth Circuit rejected the state's contention, finding that it was up to the agency, with powers delegated from Congress, to decide to what extent preemption was appropriate. *Id.* at 1051 (rejecting "an overly narrow interpretation of Congress' intent in enacting the HOLA"). Because the federal regulations made clear that a federal thrift was entitled to use the remedy of foreclosure, even on a Texas "homestead," the Fifth Circuit held preempted the Texas law.

B. The OTS Regulations Preempt The California Law Of Implied Employment Contracts.

In the instant case, respondent Maynard claimed an "implied" employment contract that she would not be discharged from her job except for proven good cause. She did not allege a written contract, much less one that was board-approved. She alleged only that she thought

her job was "secure" based on her length of service, her job performance, and possibly oblique remarks made by her supervisor. California, like some other states, recognizes implied-in-fact employment contracts of this kind. The OTS regulations, however, prohibit – and preempt claims based on – the kind of contract alleged here.

1. The OTS regulations specify precisely what is and what is not an enforceable employment contract.

One of Congress' primary regulatory objectives was to ensure that thrifts – and the federal regulators that sometimes have to take them over, at taxpayer expense – are not saddled with unknown, indeterminate and possibly improvident obligations. Congress and the OTS sought to make the thrifts' boards of directors more accountable for the thrifts' fiscal health. One aspect of such accountability, the OTS determined, is that each thrift's board should be able to determine the existence and nature of the institution's obligations under employment contracts. Accordingly, the OTS promulgated 12 C.F.R. § 563.39, which specifies that a savings association is powerless to enter into any employment contracts which are not (i) in writing, and (ii) approved by the association's board of directors.

Section 563.39 of the OTS regulations specifically forbids implied-in-fact employment contracts; the regulation even forbids written contracts that lack board approval:

> A savings association may enter into an employment contract with its officers and other

> employees *only in accordance with the requirements of this section. All employment contracts shall be in writing and shall be approved specifically by an association's board of directors.* . . . Each employment contract shall provide . . . [t]hat the association's board of directors may terminate the officer or employee's employment *at any time.* . . .

12 C.F.R. § 563.39 (emphasis added).

The drafting history of § 563.39 further underscores the case for preemption. When a predecessor regulation was adopted in 1974, the key requirement was only that a contract receive "specific approval of [the thrift's] board of directors." 39 Fed. Reg. 28609, 28610 (1974) (codified at 12 C.F.R. § 545.25-1(a)). Thus, while board approval was required, there then was no requirement of a writing.

By 1982, however, the regulators had become even more concerned about the potential abuse inherent in "long-term employment contracts and fringe benefit contracts for . . . officers." 47 Fed. Reg. 17471 (1982). The OTS's predecessor agency effected a number of changes, including revising § 563.39(a) to provide that *"[a]ll employment contracts shall be in writing* and shall be approved specifically by an institution's board of directors." *Id.* at 17472.

Even under the 1974 version an "implied" contract was forbidden, since by definition it lacked "specific [board] approval." But the express addition of the requirement of a writing made even more clear that an implied contract simply is not cognizable.

Since 1982, the OTS has established stricter rules even for written, board-approved contracts. Its current guidelines require the board of directors of each association to review all employment contracts annually; employment contracts "may only be renewed or extended upon explicit review and approval by the board of directors." OTS Reg. Bull. 27a, *Executive Compensation & Employment Contracts*, ¶ 27,107 (March 5, 1993). Plainly, therefore, the board of directors cannot satisfy this obligation with respect to ephemeral "implied" employment contracts; there is nothing to "review" or "approv[e]."

And even written, board-approved contracts are restricted in duration. The OTS prohibits

> [c]ontracts that contain automatic renewals or extensions of the contract without providing explicit review and approval by the board of directors;

and

> *[c]ontracts that provide for an excessive term.* As a general matter, a one-year term is not objectionable; *a term exceeding three years is generally objectionable.*

Id. (emphasis added). If a written, board-approved, three-year contract is condemned, *a fortiori* so is an "implied" contract for an employee's working life, such as that claimed by Maynard here.

2. California and many other states recognize implied employment contracts that are unwritten and sometimes even ephemeral.

The most significant development in employment law over the past decade is the explosion of state-law wrongful-discharge suits. In almost every state the "employment at will" doctrine has been eroded by exceptions. One of the most common of these exceptions is the doctrine of implied employment contracts. In many states an employment contract arises from factors such as length of service, favorable performance reviews, employee handbooks, the existence of internal disciplinary-review procedures, and the like. In the seminal California case, *Pugh v. See's Candies, Inc.*, 116 Cal. App. 3d 311, 171 Cal. Rptr. 917 (1981), the court explained that "an implied-in-fact promise for . . . continued employment" may be inferred from:

> the personnel policies or practices of the employer, the employee's longevity of service, actions or communications by the employer reflecting assurances of continued employment, and the practices of the industry in which the employee is engaged.

Id. at 327 (footnotes omitted). In such cases, the contract need not be in writing.[9]

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[9] Indeed, the statute of frauds – the normal protection against hard-to-disprove claims of unwritten contractual obligations – has been held inapplicable in such cases. *E.g., Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 671-75, 254 Cal. Rptr. 211 (1988) (the statute of frauds does not apply because an implied contract for permanent employment theoretically could be

In California, the existence *vel non* of an implied contract usually presents a jury question. *E.g., Foley*, 47 Cal. 3d at 682 ("plaintiff has pleaded facts which, if proved, may be sufficient for a jury to find an implied-in-fact contract limiting defendant's right to discharge him"); *see General Dynamics Corp. v. Superior Court*, No. 5033640, ___ Cal. 4th ___, ___ Cal. Rptr. 2d ___, 1994 Cal. LEXIS 3522, at *1, *53-54 (July 18, 1994) (even an in-house attorney when discharged can "pursu[e] implied-in-fact contract . . . causes of action against the employer"; these claims normally "will not be resolvable at the demurrer stage"). The consequence is that, in states where implied employment contracts can arise, an employer may be put to the risk and expense of defending before juries contract claims in cases where the employer did not know that any contract existed, much less what its terms were. Unless such cases are taken out of the hands of the jury, the jury becomes a "personnel review board" passing on, after the fact, the wisdom of business judgments made by private enterprises. *Gonzales v. MetPath, Inc.*, 214 Cal. App. 3d 422, 428, 262 Cal. Rptr. 654 (1989). As Judge Kozinski observed – perhaps only partly facetiously – California law is near the point where one can foresee lawsuits "for maliciously refusing to return telephone calls or for adopting a condescending tone in interoffice memos." *Oki America, Inc. v. Microtech International, Inc.*, 872 F.2d 312, 315 (9th Cir. 1989) (Kozinski, J., concurring); *cf. Hunio v. Tishman Construction Corp.*, 24 Cal. App. 4th 792, 818, 18 Cal. Rptr. 2d 253 (Ortega, J., concurring) ("We

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performed within one year – if, for example, the employee chose to quit or died).

seem to be on the verge of guaranteeing [employees] the right to a 'nice and easy' career."), *hearing granted*, 20 Cal. Rptr. 2d 787 (1993).

Although the law of implied employment contracts is perhaps most developed in California, the phenomenon is national in scope. Many states recognize the implied employment contract doctrine, including (for example) Arizona,[10] Colorado,[11] Illinois,[12] Maryland,[13] Michigan,[14] New Jersey,[15] and Ohio.[16]

It is true, of course, that – in general – it is up to each state to decide for itself whether to foster the proliferation of state-law implied employment-contract claims. But where state law conflicts with federal law, state law must yield.[17] That is the case here.

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[10] *E.g., Leikvold v. Valley View Community Hosp.*, 141 Ariz. 544, 688 P.2d 170 (1984).

[11] *E.g., Wing v. JMB Property Mgmt. Corp.*, 714 P.2d 916 (Colo. Ct. App. 1985).

[12] *E.g., Kaiser v. Dixon*, 127 Ill. App. 3d 251, 468 N.E. 2d 822 (1984).

[13] *E.g., Hrechorovich v. Harbor Hosp. Center Inc.*, 93 Md. App. 772, 614 A.2d 1021 (1992), *cert. denied*, 330 Md. 319, 624 A.2d 490 (1993).

[14] *E.g., Toussaint v. Blue Cross & Blue Shield of Mich.*, 408 Mich. 579, 292 N.W. 2d 880 (1980).

[15] *E.g., Gilbert v. Durand Glass Mfg. Co., Inc.*, 258 N.J. Super. 320, 609 A.2d 517 (1992).

[16] *E.g., Mers v. Dispatch Printing Co.*, 39 Ohio App. 3d 99, 483 N.E. 2d 150, 153-54 (1985).

[17] This is true regardless of the relative interest of the state in applying its own law: "The relative importance to the State of its own law is not material when there is a conflict with a valid

3. The federal regulations preempt claims based on implied employment contracts.

Federal law helps assure that thrifts do not enter into employment contracts that would be unsafe or unsound.[18] The regulatory device chosen in 12 C.F.R. § 563.39 was to prohibit implied employment contracts; indeed, even *written* contracts are prohibited unless they are board-approved. In the instant case, Maynard admits that she never had a written, much less board-approved, contract. (App. 2.) Maynard's contract claim rests only on a series of circumstances and oblique statements that, she says, taken together gave her reason to believe that her job was secure. Although in some circumstances California law may recognize such statements as enforceable contracts, 12 C.F.R. § 563.39 plainly does not.

Indeed, the OTS in a published opinion letter expressly stated that implied employment contract claims are preempted. In response to a written inquiry, the OTS explained that one cannot circumvent the rules by bypassing the thrift's board:

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federal law, for the Framers of our Constitution provided that the federal law must prevail." *de la Cuesta*, 485 U.S. at 153 (citation omitted).

[18] The regulatory history indicates that the OTS perceived the potential risk inherent in employment contracts:

> An employment contract would be an unsafe or unsound practice if it . . . could materially interfere with the exercise by the members of the board of directors of their duty or discretion . . . as to the employment or termination of employment of an officer or employee of the institution.

39 Fed. Reg. 28,610 (1974).

> The purpose of the regulation [§ 563.39] is generally to protect institutions from unsafe and unsound practices arising in connection with employment relationships. In order to prevent circumvention of the intent of this regulation, it is our belief that *its provisions should apply whe[re] there is [but] a . . . tacit employment contractual relationship. . . .*
>
> *[W]e are further of the view that the requirement in Section 12 C.F.R. 563.39(b)(1) that . . . the officer or employee's employment be terminated "at any time" would super[s]ede any contrary and conflicting state law provisions. . . .*

Ltr. Rul. No. 90/CS-46, United States Office of Thrift Supervision, 1990 OTS LEXIS 53, at *1-2 (July 3, 1990).[19]

A hypothetical, suggested by some of the abuses of the recent savings and loan scandal, helps illustrate the significant regulatory interest in preemption. Consider Executive A, a high official of the hypothetical thrift. He or she enters into oral contracts with cronies, Executives B through Z, guaranteeing them employment, at lush salaries and benefits, for their working lives. The contracts never would be approved by the thrift's outside directors, so they remain secret pacts. Perhaps the thrift then fails; or, perhaps, the OTS examiners detect and set out to clean up earlier unsavory and unsound practices. Either way, under the California court's analysis, the

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[19] Neither the California Court of Appeal panel in the instant case, nor the state courts that have reached a similar conclusion, have even cited, much less purported to distinguish, the OTS opinion and the other regulatory materials cited herein.

deals are enforceable. In the former case, the taxpayer foots the bill; even in the latter case, the OTS expends its limited regulatory resources on a problem that never should have arisen.

While there is no suggestion of cronyism or self-dealing in the instant case, it and others like it harbor an even greater risk to the public. At least in the hypothetical, the beneficiaries of the contracts could identify an express oral agreement with a senior officer. Maynard and others like her make no such claim; Maynard, for example, has conjured up her "contract" largely out of a few years of service and a few earlier pats on the back from relatively low-level supervisors. If Maynard can claim a job guarantee for her entire working life, so too could many other thrift employees. Result: a run – of lawsuits – on the bank.

California is, of course, free in general to decide what is and what is not a contract. Where, however (as here), California contract law places taxpayer-guaranteed institutions at risk, Congress and the OTS are entitled to dictate – and they have dictated – a federal rule of law.

II. THERE IS A CONFLICT; COURTS OF OTHER STATES, AND FEDERAL COURTS, HOLD PREEMPTED THE KIND OF CLAIM AT ISSUE HERE

Review by this Court is especially important because state courts and federal courts have reached conflicting results with respect to the important federal preemption question presented. *E.g.*, Sup. Ct. R. 10.1(b), (c); *Dun & Bradstreet, Inc. v. Greenmoss Builders, Inc.*, 472 U.S. 749, 753

n.1 (1985); *St. Martin Evangelical Lutheran Church v. South Dakota*, 451 U.S. 772, 780 n.10 (1981).

The California Court of Appeal in the instant case acknowledged that it was departing from the rule announced by other state courts. The court said: "While respondent cites this court to several cases from other jurisdictions which have concluded that [12 C.F.R. § 563.39] preempts state law. . . . [r]espondent has failed to persuade us [to follow them]." (App. 2-3.)

Multiple courts have indeed confirmed that § 563.39 preempts state-law implied contract claims. In *Sholer v. Security Federal Savings & Loan Association*, 736 F. Supp. 1083 (D.N.M. 1990), for example, a former bank officer sued a federal savings and loan for breach of an alleged implied contract of employment. Like Maynard here, the plaintiff in *Sholer* lacked a written, board-approved contract. The court granted the bank's motion for summary judgment even though New Mexico law (like California law) recognized oral and even implied employment contracts. The court explained that state law was preempted because:

> The presumption is . . . established [by § 563.39] that, *absent a written employment contract, the defendant could not have entered into any specific employment relationship* with the plaintiff which exceeded the scope of an at-will employment relationship.

Id. at 1085 (emphasis added).

Similarly, in *Berry v. American Federal Savings*, 730 P.2d 905 (Colo. Ct. App. 1986), a former employee

attempted to allege a claim based on an implied employment contract. Colorado law, like that of California, recognizes such contracts. But the plaintiff in *Berry* lacked a written, board-approved employment contract. The state trial court therefore granted summary judgment, and the Colorado Court of Appeals affirmed, based on the pre-emptive force of § 563.39. *Id.* at 906-07.

And, in *Hawkins v. Peoples Federal Savings & Loan Association*, 155 Mich. App. 237, 399 N.W.2d 484 (1986), the Michigan court considered the same kind of implied contract claim now at issue. The thrift invoked preemption, and the Michigan Court of Appeals agreed, reasoning: "The regulation adopted by the [OTS] is authorized by the [HOLA] and has the same pre-emptive effect on state law as a federal statute." 399 N.W.2d at 486; *cf. Dynan v. Rocky Mountain Federal Savings & Loan*, 792 P.2d 631, 639 (Wyo. Sup. Ct. 1990) (although "our rules of state law might justify [plaintiff's legal position] . . . , that rule could not control if in conflict with a provision of the federal regulations").[20]

Rush v. FDIC, 747 F. Supp. 575 (N.D. Cal. 1990), also is instructive; it emphasizes that federal preemption applies even where unfairness results. In *Rush*, a bank

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[20] In the analogous context of suits by national bank officers, many state courts have held that, when the National Bank Act applies, federal preemption bars state-law wrongful discharge actions. *E.g., City Nat'l Bank v. Brown*, 599 So. 2d 787, 790 (La. Ct. App.) (preemption by National Bank Act), *cert. denied*, 604 So. 2d 999 (La. 1992); *Sargent v. Central Nat'l Bank & Trust Co.*, 809 P.2d 1298, 1303 (Okla. Sup. Ct. 1991) (same); *Alegria v. Idaho First Nat'l Bank*, 111 Idaho 314, 723 P.2d 858, 860 (1986) (same).

subject to the OTS regulations had entered into a severance-pay contract in order to induce plaintiff to remain with a struggling institution. The commitment – made in writing by the bank's CEO, but never ratified by the board – was to pay one year's severance pay in the event that plaintiff's employment was terminated without cause. One month later, federal regulators took over the bank and terminated plaintiff's employment. Under California law, plaintiff had enforceable, vested rights under the severance-pay contract. Under 12 C.F.R. § 563.39(b)(5), however, plaintiff's state-law rights were not enforceable. The court (Weigel, J.) accordingly dismissed plaintiff's otherwise-valid state-law claim. Recognizing that application of state law instead of the federal regulation would encumber thrifts with "burdensome obligations such as substantial contracts for severance pay," and thus would deny the flexibility required to manage these institutions, the court held:

> Congress has developed a comprehensive scheme for regulating the savings and loan industry; thus *federal regulations governing the savings and loan industry preempt attempts by states to regulate in that field.*

Id. at 578 (emphasis added).[21]

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[21] *See Crocker v. Resolution Trust Corp.*, 839 F. Supp. 1291, 1294 (N.D. Ill. 1993) ("federal law governs the issues" in a contract claim brought by a former savings and loan employee; "applying [state] law will impede the Congressional intent to regulate the savings and loan industry"); *Cohen v. Resolution Trust Corp.*, No. 90-1065-R(P), 1993 U.S. Dist. LEXIS 7317, at *5 (S.D. Cal. May 10, 1993) (federal law controls in suit by a former savings and loan employee). *Cf. Langley v. FDIC*, 484 U.S. 86, 91

In the instant case, disposing of Maynard's implied employment contract claim is even more straightforward. In *Rush*, the severance-pay commitment was made at the highest level, and was not disputed. Here, by contrast, Maynard alleges only an implied employment contract arising from the acts and words of lower-level employees. Maynard would have it that her alleged employment contract is guaranteed indefinitely, potentially for her entire working life. But Home Savings' board was not informed of, much less asked to approve, such a contract. Moreover, by definition neither the board nor federal regulators could determine through due diligence the existence of the "contract," since there is no written record of it.[22] Yet under the view of the law adopted by the California Court of Appeal, there is no way a thrift's board or regulators could know which, and how many, employees potentially could bring employment-contract-for-life claims. This is simply wrong.[23]

(1987) (it is necessary to rely on a bank's *written* records) (emphasis added); *Webb v. Superior Court*, 225 Cal. App. 3d 990, 995, 275 Cal. Rptr. 581 (1991) ("The doctrine . . . reflects the equitable principle that losses incurred as a result of unrecorded arrangements should not fall on deposit insurers. . . . ").

[22] An analogous protective device is the longstanding *D'Oench, Duhme* doctrine, under which federal law bars the enforcement of certain oral and implied-in-fact loan commitments. *See generally D'Oench, Duhme & Co. v. FDIC*, 315 U.S. 447 (1942) (refusing to enforce, as unknown and unknowable, oral or implied loan commitments); 12 U.S.C. § 1823(e) (codifying the doctrine).

[23] Employees would not be left without recourse even if state-law implied-contract claims were held preempted. Employees simply would know that, to the extent that they desired greater economic security in their positions with a federal savings and loan, it

Why the California Court of Appeal declined to follow the authority from other states is not clear. While it purported to rely on prior California cases,[24] those earlier cases and the instant one seemed to reach their conclusions, at least in part, by confusing *state-court jurisdiction* with the very different concept of *preemption*. *See* App. 4-5, *quoting Hall*, 231 Cal. App. 3d at 719 ("California courts ha[ve] *jurisdiction* to hear matters arising out of employment contracts with savings associations controlled by the Office of Thrift Supervision. . . . ") (emphasis added). This confuses the analysis, of course;

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was their obligation to negotiate their contract rights in written form, and to secure appropriate ratification thereof. While it is true that, under the federal regulation, employees at all times may be *removed* at will, with or without cause, an employee thus removed would be financially protected to the extent that he or she had a written, board-approved contract, because such an employee (even though removed and ineligible for reinstatement) would have a damages claim under his or her contract. 12 C.F.R. § 563.39(b)(1). As a result, contract rights would be debated in advance, in the open, at the negotiating table, rather than litigated after the fact in court.

[24] *Hall v. Great Western Bank*, 231 Cal. App. 3d 713, 718, 282 Cal. Rptr. 640 (1991) (no preemption); *Honig v. Financial Corp. of America*, 6 Cal. App. 4th 960, 965, 7 Cal. Rptr. 2d 922 (1992) (same); *Thomka v. Financial Corp. of America*, 15 Cal. App. 4th 877, 887, 19 Cal. Rptr. 2d 382 (1993) (same). Cases from at least two other states – New Jersey and Connecticut – also have refused to acknowledge federal preemption of implied employment contract claims. *Cole v. Carteret Sav. Bank*, 224 N.J. Super. 446, 540 A.2d 923, 925 (1988) (finding no preemption; "the very promulgation of 12 C.F.R. § 563.39 bespeaks a concern about employees and their contractual arrangements with the institution"); *Paris v. Northeast Sav. Ass'n*, No. CV 910398144, 1994 Conn. Super. LEXIS 1412, at *21 (June 1, 1994) (citing, with approval, the New Jersey case, *Cole*). These other cases merely underscore the need for review to resolve the conflict.

the *existence of state-court jurisdiction* is distinct from *absence of preemption*. State courts certainly have jurisdiction to consider most state-law claims that present preemption issues. However, the existence of concurrent jurisdiction does not relieve state courts from the obligation to give supremacy to substantive federal law by applying the preemption doctrine. *E.g., Caterpillar, Inc. v. Williams*, 482 U.S. 386, 392-93 (1987) (that a state-law claim is *preempted* does not mean that federal courts have exclusive, or even removal, *jurisdiction* over the claim; federal jurisdiction is unnecessary because state courts are expected to give primacy, through the preemption doctrine, to principles of federal law).[25] Thus, in the instant case, the California court correctly found state-court jurisdiction, but seemed to make an unwarranted leap to infer from jurisdiction that the preemptive force of federal law somehow had dissipated.

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[25] This Court's review of state-court preemption cases is also vital for a practical reason: otherwise, state courts' determinations of federal preemption issues will be determinative. That is so because the preemption defense is not a proper basis for removal to federal court, "even if the defense is anticipated in the plaintiff's complaint, and . . . both parties concede that the federal defense is the only question truly at issue." *Caterpillar, Inc. v. Williams*, 482 U.S. at 392 (state-law claim of breach of employment contract is not removable to federal court, despite the existence of a federal preemption defense).

Thus, even if this Court for some reason were inclined to affirm the decision of the California Court of Appeal, the Court should grant review to resolve the issue. Because state courts will be the primary forum for the numerous wrongful discharge and related lawsuits by former employees of federal thrifts, review by this Court – whatever its ultimate decision – will serve a vital purpose simply by definitively stating the law.

Whatever may have been the thinking of the California court, it by its own admission reached a decision that flatly conflicts with the decisions of other state and federal courts. This Court should grant *certiorari* to resolve the conflict.

CONCLUSION

The petition for a writ of *certiorari* should be granted, possibly in tandem with No. 94-209, *Morales v. First Gibraltar Bank* (petition for *cert.* filed July 28, 1994). In the alternative, this petition should be held pending disposition of *Morales*.

Respectfully submitted.

PAUL W. CANE, JR.
Counsel of Record
KATHLEEN L. MCACHRAN
PAUL, HASTINGS, JANOFSKY & WALKER

FRANKLIN R. WURTZEL
Legal Department
Home Savings of America, FSB

Attorneys for Petitioner
Home Savings of America, FSB

DATED: August 10, 1994

NOT TO BE PUBLISHED

IN THE COURT OF APPEAL OF THE
STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION SEVEN

MARCELLA T. MAYNARD, Plaintiff and Appellant, v. HOME SAVINGS OF AMERICA, et al., Defendants and Respondents.	B073696 (SuperCt.No. GC7209) (Filed Feb. 17, 1994)

APPEAL from a judgment of the Superior Court of Los Angeles County. Coleman A. Swart, Judge. Reversed.

Noel Shipman for Plaintiff and Appellant.

Paul, Hastings, Janofsky & Walker and Paul W. Cane, Jr., for Defendants and Respondents.

Marcella T. Maynard appeals from summary judgment and contends the trial court erred in concluding federal regulations preempted her claim.

STATEMENT OF FACTS AND PROCEDURAL HISTORY

On May 15, 1992, Maynard filed a complaint in superior court against Home Savings of America (Home Savings) for breach of an implied in fact employment contract and breach of the implied covenant of good faith and fair dealing.

Home Savings filed an answer to the complaint and thereafter each party filed a motion for summary judgment/summary adjudication. Home Savings' motion was brought on the ground that Maynard's claims were preempted by federal law.

It was undisputed between the parties that Maynard was vice president of Home Savings when she was terminated on October 10, 1991; during her employment, she never had a written, Board-approved employment contract; Home Savings is a federal savings association chartered under Section 5 of the Home Owners' Loan Act, 12 United States Code, sections 1461-1470 and subject to federal regulations promulgated by the Office of Thrift Supervision.

The trial court granted Home Savings' motion for summary judgment finding Maynard's claims were preempted by 12 Code of Federal Regulations, section 563.39.

DISCUSSION

Maynard's contention that the trial court erred in granting summary judgment is well taken. While respondent cites this court to several cases from other jurisdictions which have concluded that 12 Code of Federal

Regulations, section 563.39 preempts state law, there are three California cases on the subject, all from this district and all conclude the subject regulation does not preempt California law. Respondent has failed to persuade us that this court should conclude otherwise and we, therefore, reverse the summary judgment.

Home Savings is a federal savings association chartered under section 5 of the Home Owners' Loan Act and subject to regulations promulgated by the Office of Thrift Supervision. One such regulation is 12 Code of Federal Regulations, section 563.39, which is entitled "Employment contracts" and provides in relevant part: "(a) *General.* A savings association may enter into an employment contract with its officers and other employees only in accordance with the requirements of this section. All employment contracts shall be in writing and shall be approved specifically by an association's board of directors. . . . [¶] (b) *Required provisions.* Each employment contract shall provide that: [¶] (1). The association's board of directors may terminate the officer or employee's employment at any time, but any termination by the association's board of directors other than termination for cause, shall not prejudice the officer or employee's right to compensation or other benefits under the contract. The officer or employee shall have no right to receive compensation or other benefits for any period after termination for cause. Termination for cause shall include termination because of the officer or employee's personal dishonesty, incompetence, willful misconduct, breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, willful violation of any law, rule, or regulation (other than traffic violations

or similar offenses) or final cease-and-desist order, or material breach of any provision of the contract."

In California, the employment relationship is presumptively "at will" but provides remedies for employment termination which contravenes an express or implied agreement for job security, which stems from a "pernicious form of discrimination" or which violates clear, fundamental public policy. (*Hall v. Great Western Bank* (1991) 231 Cal.App.3d 713, 718.)

Under the broad preemption principles set forth by the United States Supreme Court in *Fidelity Federal S. & L. Assn. v. de la Cuesta* (1982) 458 U.S. 141 [73 L.Ed.2d 664, 102 S.Ct. 3014] federal statutes and regulations will preempt conflicting state law. A state law is in conflict when compliance with it is physically impossible in view of the federal mandate or when state law presents an obstacle to the accomplishment and execution of the purpose of Congress. (See *Cole v. Carteret Sav. Bank* (1988) 224 N.J. Super. 446 [540 A.2d 923, 924].)

In 1991, Division Four of this court analyzed relevant state and federal law and concluded that California law did not conflict with the provisions of 12 Code of Federal Regulations, section 563.39. In reaching this conclusion, this court reasoned that the "regulation specifically and unambiguously protects an 'employee's right to compensation or other benefits under the contract' in the event the employee is fired without cause. Thus, the regulation provides protection to employees which is similar to that provided under state law where there exists a valid agreement for job security." (*Hall v. Great Western Bank, supra,* 231 Cal.App.3d at p. 719, fn. omitted.) Division

Four noted further that neither the federal law (12 U.S.C. § 1464) nor the regulation promulgated pursuant to such authority (12 C.F.R. § 563.39) contained "dismiss at pleasure" language. (*Hall v. Great Western Bank, supra,* 231 Cal.App.3d at p. 720.)

In 1992, Division Five of this court in *Honig v. Financial Corp. of America* (1992) 6 Cal.App.4th 960, 964-965, agreed with the conclusions in *Hall* that California courts had jurisdiction to hear matters arising out of employment contracts with savings associations controlled by the Office of Thrift Supervision and that 12 Code of Federal Regulations, section 563.39 did not preempt California state law.

Most recently, in 1993, this Division, in *Thomka v. Financial Corp.* (1993) 15 Cal.App.4th 877, 885-887, agreed with the conclusions reached in *Hall v. Great Western Bank, supra,* 231 Cal. App.3d at p. 720, and *Honig v. Financial Corp. of America, supra,* 6 Cal.App.4th 960. (See also *Cole v. Carteret Sav. Bank, supra,* 540 A.2d 923.) Based on the foregoing, the summary judgment must be reversed.

DISPOSITION

The judgment is reversed. Appellant shall receive costs on appeal.

NOT TO BE PUBLISHED

LILLIE, P.J.

We concur:

JOHNSON, J.
WOODS (Fred), J.

Second Appellate District, Division Seven,
No. B073696 S038776

IN THE SUPREME COURT OF THE
STATE OF CALIFORNIA

IN BANK

(Filed May 12, 1994)

MARCELLA T. MAYNARD, Appellant

v.

HOME SAVINGS OF AMERICA Et Al., Respondents

Respondents' petition for review DENIED.

LUCAS
Chief Justice

12 C.F.R. § 545.2 Federal preemption.

The regulations in this part 545 are promulgated pursuant to the plenary and exclusive authority of the Office to regulate all aspects of the operations of Federal savings associations, as set forth in section 5(a) of the Act. This exercise of the Office's authority is preemptive of any state law purporting to address the subject of the operations of a Federal savings association.

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12 C.F.R. § 563.39 Employment contracts.

(a) *General.* A savings association may enter into an employment contract with its officers and other employees only in accordance with the requirements of this section. All employment contracts shall be in writing and shall be approved specifically by an association's board of directors. An association shall not enter into an employment contract with any of its officers or other employees if such contract would constitute an unsafe or unsound practice. The making of such an employment contract would be an unsafe or unsound practice if such contract could lead to material financial loss or damage to the association or could interfere materially with the exercise by the members of its board of directors of their duty or discretion provided by law, charter, bylaw or regulation as to the employment or termination of employment of an officer or employee of the association. This may occur, depending upon the circumstances of the case, where an employment contract provides for an excessive term.

(b) *Required provisions.* Each employment contract shall provide that:

(1) The association's board of directors may terminate the officer or employee's employment at any time, but any termination by the association's board of directors other than termination for cause, shall not prejudice the officer or employee's right to compensation or other benefits under the contract. The officer or employee shall have no right to receive compensation or other benefits for any period after termination for cause. Termination for cause shall include termination because of the officer or employee's personal dishonesty, incompetence, willful misconduct, breach of fiduciary duty involving personal profit, intentional failure to perform stated duties, willful violation of any law, rule, or regulation (other than traffic violations or similar offenses) or final cease-and-desist order, or material breach of any provision of the contract.

(2) If the officer or employee is suspended and/or temporarily prohibited from participating in the conduct of the association's affairs by a notice served under section 8 (e)(3) or (g)(1) of Federal Deposit Insurance Act (12 U.S.C. 1818 (e)(3) and (g)(1)) the association's obligations under the contract shall be suspended as of the date of service unless stayed by appropriate proceedings. If the charges in the notice are dismissed, the association may in its discretion (i) pay the officer or employee all or part of the compensation withheld while its contract obligations were suspended, and (ii) reinstate (in whole or in part) any of its obligations which were suspended.

(3) If the officer or employee is removed and/or permanently prohibited from participating in the conduct

of the association's affairs by an order issued under section 8 (e)(4) or (g)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1818 (e)(4) or (g)(1)), all obligations of the association under the contract shall terminate as of the effective date of the order, but vested rights of the contracting parties shall not be affected.

(4) If the savings association is in default (as defined in section 3(x)(1) of the Federal Deposit Insurance Act), all obligations under the contract shall terminate as of the date of default, but this paragraph (b)(4) shall not affect any vested rights of the contracting parties: *Provided,* that this paragraph (b)(4) need not be included in any employment contract if prior written approval is secured from the Director or his or her designee.

(5) All obligations under the contract shall be terminated, except to the extent determined that continuation of the contract is necessary of the continued operation of the association

(i) By the Director or his or her designee, at the time the Federal Deposit Insurance Corporation or Resolution Trust Corporation enters into an agreement to provide assistance to or on behalf of the association under the authority contained in 13(c) of the Federal Deposit Insurance Act; or

(ii) By the Director or his or her designee, at the time the Director or his or her designee approves a supervisory merger to resolve problems related to operation of the association or when the association is determined by the Director to be in an unsafe or unsound condition.

Any rights of the parties that have already vested, however, shall not be affected by such action.

¶ 27,107

#RB 27a EXECUTIVE COMPENSATION AND EMPLOYMENT CONTRACTS

March 5, 1993

Summary: This bulletin provides guidance to regulatory personnel for review of compensation provisions and clarifies OTS policy regarding unsafe and unsound practices relating to executive compensation and employment contracts contained in 12 C.F.R. §§ 563.39 and 563.161. This Bulletin further clarifies a number of issues that arose in connection with Regulatory Bulletin (RB) 27 and re-emphasizes OTS policy to defer to healthy thrifts' boards of directors in compensation matters. RB 27, dated November 8, 1991, is rescinded with the issuance of this Bulletin.

* * *

The Director of the Office of Thrift Supervision (OTS) has authority under § 4(a)(1) of the Home Owners' Loan Act (HOLA) to provide for the safe and sound operation of savings associations. Section 8(b)(6) of the Federal Deposit Insurance Act authorizes each regulatory agency to take actions to limit the terms of, or to prohibit an insured depository institution from entering into or making payments under, any contracts between an insured depository institution and an institution-affiliated party that constitute an unsafe or unsound banking practice.

General policy. The OTS will ordinarily give healthy institutions deference concerning compensation levels and compensation arrangements for their directors and senior executive officers. All MACRO factors, not just

capital, will be considered in the review of employment contracts and other compensation arrangement.

As a general rule, the OTS will defer to the savings association's board of directors concerning executive compensation arrangements, provided the following conditions are met:

- The savings association is not a problem association,
- The compensation arrangements do not present significant safety or soundness concerns that could lead to material financial loss or damage to the association, and [sic]

The OTS requires the board of directors of each association to annually review all employment contracts and compensation arrangements for senior executive officers and directors and to document their justification and approval in the board minutes. Directors who have a personal interest in the compensation arrangements should not participate in the deliberations on or vote on the arrangements. Employment contracts may only be renewed or extended upon explicit review and approval by the board of directors.

Prior approval requirement. All problem associations should submit employment contracts for senior executive officers and directors to the Regional Director for prior review. The Regional Director may extend this requirement to other employees of the savings association as well. Compensation at problem institutions requires regulatory scrutiny on a case-by-case basis in order to balance a problem institution's need to lower operating

expenses against the need to provide a higher than normal level of compensation to attract or retain qualified management.

Definitions. "Compensation" includes any payment of money or provision of any other thing of value in consideration of employment, including, without limitation, base salary, commissions, bonuses, pension and profit sharing plans, severance payments, retirement, director or committee fees, fringe benefits, [and] payment of expense items without accountability or business purpose or that do not meet the IRS requirements for deductibility by the association. The grant or exercise of stock options will not ordinarily be considered compensation unless they are so material in amount or conditioned upon factors that result in incentives that cause supervisory concerns.

A "senior executive officer" includes any individual who exercises significant influence over, or participates in major policymaking decisions of, a savings association without regard to title, salary, or compensation. The term includes but is not limited to the president, chief executive officer, chief operating officer, chief financial officer, chief lending officer, chief investment officer, general counsel, or their functional equivalents.

A "director" is any individual who is a member of the board of directors of the association or of any subsidiary of the association.

An "employment contract" is any agreement, intended to be legally enforceable that materially affects the terms and conditions of a person's employment.

A "problem" association is defined as an association that: (1) has a composite MACRO rating of 4 or 5; (2) is undercapitalized under prompt corrective action standards; (3) is subject to a capital directive or a cease and desist order, a consent order, or a formal written agreement, relating to the safety and soundness or financial viability of the savings association, unless otherwise informed in writing by the OTS; or (4) has been notified in writing by the OTS that it has been designated a problem association or an association in troubled condition.

Existing contracts. The OTS will review, comment, and take appropriate action to correct existing employment contracts that are deemed to be unsafe or unsound.

The OTS will not generally require changes to preexisting contracts in health institutions. Contract provisions, however, that raise significant safety and soundness concerns will be subject to examination comment or formal enforcement actions until the contract is terminated or modified. The OTS may, on safety and soundness grounds, insist that the board replace unacceptable managers and use its best efforts to renegotiate employment contracts that are excessively burdensome on the institution.

Unsafe or unsound practices. The following guidelines are illustrative, not exhaustive, examples of compensation provisions considered unsafe or unsound. Other compensation provisions may also be objectionable depending on individual circumstances. These guidelines are based on safety and soundness concerns that are especially important for problem associations. Regulators

must use judgment in the application of the guidelines, taking into account the condition of the institution, the reason for the provision and the materiality of the provision.

Regulators should review compensation provisions in problem associations under these guidelines (1) during examinations, (2) in conjunction with applications that contain compensation arrangements, and (3) when employment contracts and compensation payments are submitted for review by problem associations.

- Compensation arrangements that provide incentives contrary to the safe and sound operation of the association. For example, compensation based primarily on short-term operating results may encourage unreasonable risk-taking to achieve short-term profits. Compensation tied to current operating results should be closely monitored by the board of directors.

- Compensation arrangements that provide for compensation that significantly exceeds compensation paid to persons with similar responsibilities and duties in other insured institutions of similar size, in similar locations, and under similar circumstances, including health and profitability.

- Contracts that contain automatic renewals or extensions of the contract without providing explicit review and approval by the board of directors.

- Contracts that provide for an excessive term. As a general matter, a one-year term is not objectionable; a term exceeding three years is generally objectionable.

- Total compensation paid out upon the departure of an employee, regardless of the reason, that exceeds three

times the employee's average annual compensation.[1] Total compensation must include payments for the remaining contract term, if applicable, as well as any severance payments. Average annual compensation should be based on the most recent five taxable years.

- Contracts that do not adequately reflect or define the duties and responsibilities of the employee.
- Compensation programs (including deferred compensation/retirement/insurance) for independent directors that are not commensurate with their duties, or that jeopardize their independence, such as vesting requirements that would require an independent director to forfeit previously accrued amounts if they did not serve for a minimum number of years.
- Contracts that are collateralized or otherwise guaranteed by the savings association, unless the contract terms provide that the contract is unenforceable if the association becomes a problem association, or unless the contract is approved by the Regional Director. Guarantees provided solely by the holding company are permissible.
- Contracts that provide for employer reimbursement of costs incurred by employees seeking to enforce employment contract terms in the absence of legal judgment or settlement.
- Change-in-control provisions that provide for immediate vesting, particularly for problem institutions.
- Generally, any contract that requires payment upon the voluntary resignation of the employee will be examined carefully to determine whether it is unsafe and unsound.

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[1] In the case of termination for cause, however, no payments should be made.

RB 27a does not apply to employment contracts or other compensation arrangements between a holding company and a holding company executive. Employment contracts between a holding company and a thrift executive are not covered unless such contract or arrangement is likely to adversely affect the financial or managerial condition of the association. If applicable, separate contracts should be maintained between a thrift executive and the association and the thrift executive and the holding company.

The following "golden parachute" provision should be included in new and renewed employment contracts: "Any payments made to the employee pursuant to this agreement, or otherwise, are subject to and conditioned upon their compliance with 12 USC § 1828(k) and any regulations promulgated thereunder."

1990 OTS LEXIS 53 printed in FULL format.

Office of Thrift Supervision

1990 OTS LEXIS 53

July 3, 1990

SUBJECT: [*1] Employment Contracts
90/CS-46

Dear Text Omitted

This is in response to your letter to the Secretary of the Federal Home Loan Bank Board ("FHLBB") requesting assistance in the interpretation of 12 C.F.R. Sections 545.122 and 563.39. We apologize for the delay in our response.

Specifically, the two questions that you have asked are the following:

1. Is it correct that, as to rank and file employees for whom no written contract exists, the regulations in question do not apply?

2. Is the requirement that all such written contracts be terminable "at any time" intended to abrogate any state rights which may accompany at-will employment? Or alternatively, was such a provision merely intended to preclude contracts of employment for a stated term?

Although we are unaware of the specific facts and the specific context for which these questions were asked, we can respond generally to the queries. However, it should be noted that specific facts, circumstances, or conditions might require different conclusions. n1

n1 It should also be noted that the wording of Section 545.122 that you quote is inaccurate. The current Section (and the Section at the time of your opinion request) states: "A Federal association, upon specific approval of its board of directors, may enter into employment contracts with its officers an other employees in accordance with Section 563.39 of this Chapter. [*2]

Discussion

The Office of Thrift Supervision ("OTS"), formerly the FHLBB, generally permits institutions to enter into employment contracts with their officers and other employees in accordance with specific regulatory requirements. These regulatory requirements are contained in 12 C.F.R. Section 563.39. n2

n2 The section applicable to federal institutions, 12 C.F.R. Section 545.121, specifically permits employment contracts in accordance with Section 563.39.

In response to your first question, in our view, the provisions of Section 563.39 would apply to all employees regardless of whether or not they have actual written employment contracts. The purpose of the regulation is generally to protect institutions from unsafe and unsound practices arising in connection with employment relationships. In order to prevent circumvention of the intent of this regulation, it is our belief that its provisions should apply whether there is a written or tacit employment contractual relationship.

In response to your second question, we are further of the view that the requirement in Section 12 C.F.R.

563.39(b)(1) that the termination of the officer or employee's employment be terminated [*3] "at any time" would supercede any contrary and conflicting state law provisions governing at-will employment. Specifically stated in the regulation, however, is the exception that, unless the termination is for cause, the dismissal shall not prejudice the officer or employee's right to compensation or other benefits under the contract. These compensation and other benefits rights could be provided for under state law, and the intent of the regulation is not to abrogate these specific state rights. Also, in response to the second part of this question, this particular regulatory provision does not preclude contracts of employment for a stated term, although, depending upon the particular facts and circumstances, supervisory objection may be taken to provisions of a particular employment contract, including objection based upon an excessive term of the contract. We suggest that you discuss terms of particular contracts with the OTS supervisory staff responsible for the particular savings association to which the contract pertains.

If you have any further questions or comments on this matter, please contact Valerie J. Lithotomos, Staff Attorney, Corporate and Securities Division, [*4] at (202) 906-6439.

Very truly yours,

(Signed)
Julie L. Williams
Deputy Chief Counsel